

Initial Draft

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TO: Dave Beran
FROM: Andrew Schwartz
SUBJECT: Specialty Bakery Retail Coffee Shops (SBRC)

DATE: May 11, 1990

An opportunity exists for PM-USA to gain a competitive edge by pioneering cigarette merchandising at Specialty Bakery Retail Coffee shops (SBRC). This class of trade is dominated by market leaders: Dunkin' Donuts, Mister Donut, and Winchell's Doughnut Houses. All together, these three companies represent close to 70% of the more than 4,000 franchised doughnut shops in the United States. SBRC's do not currently carry cigarettes and typically do not have cigarette vending machines. The analysis which follows supports my recommendation to develop and test SBRC's potential to increase our cigarette volume and visibility in a trade class unencumbered by competitive retail presence.

Customer Base Synergies

The interdependence of coffee and cigarette use can hardly be disputed. The association between coffee and cigarette consumption is well documented in academic and health journals and is confirmed by syndicated data from Simmons, MRI, and the Roper Organization. A search of this literature reveals that:

- The incidence of coffee use is significantly higher among smokers than non-smokers.
- Coffee and cigarette use are positively correlated by volume and frequency of use with smokers shortening the interval between cigarettes immediately following coffee consumption.

The federal government commissions an annual study contrasting consumer expenditures of smoking and non-smoking households. Consistently over time, the smoking households spent considerably more on coffee than their non-smoking counterparts. The latest available data indicate that:

- Smoking households spend 73% more on coffee than non-smoking households.

The love affair between a smoker and his cup of coffee was also quantified in PM-USA's 1987 Social Acceptability Study, in which:

- Half (49.5%) the smokers contacted mostly agreed (19.4%) or completely agreed (30.1%) that their favorite time to smoke was with a cup of coffee.

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Retail Dynamics

From the interdependence of our customer bases, it is reasonable to believe that a disproportionate number of smokers patronize the SBRC trade class. Marketing spending to develop a unique presence in the SBRC environment would offer three primary benefits: visibility and access to a large number of smokers, brand choice limited to PM-USA products, and a lead in developing this promising retail environment. We have a rare opportunity to define cigarette merchandising in SBRC's without competitive p.o.s. or long standing fixture relationships.

Mutually Beneficial Relationship

Our potential involvement with the SBRC trade class would be a mutually beneficial relationship. Cigarette availability would provide another reason to stop at a Dunkin' outlet, providing not only the profit potential inherent in our products but a stimulus to increase sales of their entire product line via increased traffic. Unlike a new food item, our products offer only incremental revenues without cannibalization of their existing product line. According to trade articles quoting senior marketing management at Winchells and Dunkin' Donuts, the largest hurdle to their business growth is giving customers a reason to stop at their stores. This understanding is communicated with Dunkin's long running "Its worth the trip" campaign and the stimulus driving aggressive efforts to merchandise their products at grocery and convenience stores. Cigarette availability offers another reason to stop at this trade class, capturing customers lost to c-stores and delicatessens.

Traffic Patterns

High traffic locations are as important to SBRC's as they are to us in the convenience oriented cigarette category. Drawing a customer out to a dedicated specialty retail food store might be as hard as convincing a smoker to regularly buy their smokes at a store which sold only cigarettes.

- Over the next few years, several SBRC competitors will be adding thousands of kiosks at airports and subway stations while adding express service counters and drive-thru windows at the traditional free-standing shops.

Trade articles quoting senior SBRC management cite that more than half their sales are earned between 6:00 and 10:00 AM. Similarly, cigarette sales in convenience stores occur disproportionately in the morning hours. This finding is based upon a 1988 major markets study conducted every few years by 7-Eleven. Presumably, many pack smokers are purchasing their cigarettes for the day on the way to work. This finding implies that:

- SBRC's can benefit by offering our products to their heavy morning customer base.
- Heavy morning traffic is beneficial to moving our products at retail.

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Competitive Products At Kraft - General Foods

Although Kraft-General Foods competes categorically in coffee and baked goods, we do not compete at the specialty retail level. Cigarette cross-promotions with many of our other brands have been avoided, for fear of consumer boycotts and adverse publicity. An association outside the PM family of brands would greatly reduce our exposure and should not adversely affect our coffee or baked goods businesses.

Proposal - Retail Testing

I propose that we develop with Sales Planning a retail test of matched SBRC outlets which measures the:

- o impact of p.o.s.
- o value of cross-promotional offers.
- o in-market potential of entering the SBRC trade class.

The national trend towards consumer convenience manifests itself in the cigarette industry as increased pack sales in convenience stores. I believe the time to build a relationship with this trade class is now before the tremendous potential inherent in SBRC outlets and their expansion plans are realized by our competitors. I would like to meet with you at your earliest convenience to discuss this opportunity and next steps with Sales Planning, if appropriate.

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Dunkin' Donuts and C Store Outlets By Census Region

	DUNKIN #	DUNKIN %	C STORES #	C STORES	INDEX
TOTAL	<u>1554</u>	<u>100.0%</u>	<u>69205</u>	<u>100.0%</u>	<u>100</u>
NEW ENGLAND	<u>398</u>	<u>25.6%</u>	<u>3799</u>	<u>5.5%</u>	<u>467</u>
MAINE	28	1.8%	560	0.8%	223
NEW HAMPSHIRE	39	2.5%	373	0.5%	466
VERMONT	8	0.5%	181	0.3%	197
MASS	196	12.6%	1697	2.5%	514
RHODE ISLAND	49	3.2%	275	0.4%	794
CONN	78	5.0%	713	1.0%	487
MID ATLANTIC	<u>472</u>	<u>30.4%</u>	<u>5084</u>	<u>7.3%</u>	<u>413</u>
NEW YORK	229	14.7%	1936	2.8%	527
NEW JERSEY	138	8.9%	1196	1.7%	514
PENN	105	6.8%	1952	2.8%	240
EAST NO CENTRAL	<u>264</u>	<u>17.0%</u>	<u>9098</u>	<u>13.1%</u>	<u>129</u>
OHIO	48	3.1%	2842	4.1%	75
INDIANA	21	1.4%	1266	1.8%	74
ILLINOIS	132	8.5%	1617	2.3%	364
MICHIGAN	51	3.3%	2466	3.6%	92
WISCONSIN	12	0.8%	907	1.3%	59
WEST NO CENTRAL	<u>15</u>	<u>1.0%</u>	<u>5085</u>	<u>7.3%</u>	<u>13</u>
MINNESOTA	2	0.1%	1330	1.9%	7
IOWA	0	0.0%	988	1.4%	0
MISSOURI	8	0.5%	1357	2.0%	26
NORTH DAKOTA	0	0.0%	152	0.2%	0
SOUTH DAKOTA	0	0.0%	180	0.3%	0
NEBRASKA	0	0.0%	341	0.5%	0
KANSAS	5	0.3%	737	1.1%	30

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Dunkin' Donuts and C Store Outlets By Census Region

	DUNKIN #	DUNKIN %	C STORES #	C STORES	INDEX
SOUTH ATLANTIC	<u>238</u>	<u>15.3%</u>	<u>18700</u>	<u>27.0%</u>	<u>57</u>
DELAWARE	8	0.5%	144	0.2%	247
MARYLAND	40	2.6%	900	1.3%	198
DIST OF COL	1	0.1%	80	0.1%	56
VIRGINIA	26	1.7%	2484	3.6%	47
WEST VA	2	0.1%	652	0.9%	14
NO CAROLINA	14	0.9%	3450	5.0%	18
SO CAROLINA	11	0.7%	1797	2.6%	27
GEORGIA	32	2.1%	3266	4.7%	44
FLORIDA	104	6.7%	5927	8.6%	78
EAST SO CENTRAL	<u>20</u>	<u>1.3%</u>	<u>6480</u>	<u>9.4%</u>	<u>14</u>
KENTUCKY	8	0.5%	1005	1.5%	35
TENNESSEE	8	0.5%	2319	3.4%	15
ALABAMA	4	0.3%	1935	2.8%	9
MISSISSIPPI	0	0.0%	1221	1.8%	0
WEST SO CENTRAL	<u>62</u>	<u>4.0%</u>	<u>10963</u>	<u>15.8%</u>	<u>25</u>
ARKANSAS	0	0.0%	743	1.1%	0
LOUISIANA	4	0.3%	1512	2.2%	12
OKLAHOMA	9	0.6%	1446	2.1%	28
TEXAS	49	3.2%	7262	10.5%	30

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Dunkin' Donuts and C Store Outlets By Census Region

	DUNKIN #	DUNKIN %	C STORES #	C STORES	INDEX
MOUNTAIN	<u>66</u>	<u>4.2%</u>	<u>4182</u>	<u>6.0%</u>	<u>70</u>
MONTANA	0	0.0%	337	0.5%	0
IDAHO	0	0.0%	361	0.5%	0
WYOMING	1	0.1%	185	0.3%	24
COLORADO	14	0.9%	989	1.4%	63
NEW MEXICO	14	0.9%	547	0.8%	114
ARIZONA	37	2.4%	1062	1.5%	155
UTAH	0	0.0%	435	0.6%	0
NEVADA	0	0.0%	266	0.4%	0
PACIFIC	<u>39</u>	<u>2.5%</u>	<u>5814</u>	<u>8.4%</u>	<u>30</u>
WASHINGTON	7	0.5%	1064	1.5%	29
OREGON	11	0.7%	693	1.0%	71
CALIFORNIA	17	1.1%	3890	5.6%	19
ALASKA	3	0.2%	69	0.1%	194
HAWAII	1	0.1%	98	0.1%	45

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